

Letter of Findings: 10-0166
Use Tax
For the Year 2007

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ISSUE

I. Use Tax—Recreational Vehicle.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-8.1-5-1; [45 IAC 2.2-3-4](#); Gregory v. Helvering, 293 U.S. 465 (1935); Comm'r v. Transp. Trading & Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Horn v. Comm'r, 968 F.2d 1229 (D.C. Cir. 1992); Lee v. Comm'r, 155 F.3d 584 (2nd Cir. 1998).

Taxpayer protests the imposition of use tax on the use of recreational vehicles.

Tax Administration – Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of negligence penalty.

STATEMENT OF FACTS

Taxpayer is an individual and is a resident of Indiana. The Indiana Department of Revenue ("Department") determined that in 2007 Taxpayer purchased recreational vehicles ("RVs") in Kentucky and had been using the RVs in Indiana without paying sales tax in any jurisdiction. As a result, the Department issued proposed assessments for use tax, ten percent negligence penalty, and interest. Taxpayer protests that the RVs were titled by a Montana LLC, of which Taxpayer and his wife are the sole members, and that no Indiana sales or use tax is due. An administrative hearing was conducted and this Letter of Findings results. Further facts will be supplied as required.

I. Use Tax—Recreational Vehicle.

DISCUSSION

Taxpayer protests the imposition of use tax on the use and storage of two RVs in Indiana. The Department imposed use tax after determining that Taxpayer had been using and storing the RVs in Indiana and that no sales tax had been paid on the purchase of the RVs. Taxpayer protests that the RVs were titled by a Montana LLC and that all legal documents establishing the existence of the LLC were properly filed in Montana. Taxpayer also argues that the RVs were used in Texas and not in Indiana. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

The sales tax is imposed by IC § 6-2.5-2-1, which states:

- (a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.
- (b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

The use tax is imposed under IC § 6-2.5-3-2(a), which states:

- (a) An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.

Also, [45 IAC 2.2-3-4](#) provides:

Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail tax has been collected at the point of purchase.

Therefore, when tangible personal property is acquired in a retail transaction and is stored, used, or consumed in Indiana, Indiana use tax is due if sales tax has not been paid at the point of purchase. The Department determined that Taxpayer purchased the RVs in Kentucky in retail transactions in 2007, and as a resident of Indiana, stored or used the RVs in Indiana but did not pay sales tax anywhere. The Department therefore issued proposed assessments for use tax.

Taxpayer explains that he and his wife purchased an RV in Kentucky in 2007. Shortly thereafter that same year they had problems with the RV so they traded it back to the Kentucky dealership for another RV. Both of these vehicles were purchased by the Montana LLC and licensed in Montana. Taxpayer states that the Montana LLC's legal documents were properly filed in Montana. Furthermore, Taxpayer argues that for several years he and his wife would spend seven months a year in Texas, where they resided in their RVs and consequently the RVs were never used or stored in Indiana. Taxpayer explains that when he and his wife decided to discontinue their seasonal residence in Texas they traded in their second RV for a newer, smaller model that they now keep

in Indiana and that is properly titled in Indiana.

During the hearing, Taxpayer was asked for any documentation that would support the contention that he and his wife lived in Texas for part of the year and that documented use of the RV in Texas. Taxpayer was afforded additional time to provide such documentation, but no such documentation was forthcoming.

Also, there are no LLC documents establishing any business activity at all in Indiana, Montana, or any other state in the union. Plainly, the LLC was not pursuing its stated reason for existence, which was to conduct business. The sole activity of the Montana LLC was to hold title to the RV.

While the LLC made no attempt to undertake any business activity, the titling of the RVs by the LLC did have a significant impact on Taxpayer's sales taxes. This leads to consideration of the "sham transaction" doctrine, which is long established both in state and federal tax jurisprudence dating back to *Gregory v. Helvering*, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. *Id.* at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[T]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." *Id.* at 470.

The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." *Comm'r v. Transp. Trading & Terminal Corp.*, 176 F.2d 570, 572 (2nd Cir. 1949), cert. denied, 338 U.S. 955 (1950). "[T]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. *Horn v. Comm'r*, 968 F.2d 1229, 1236-7 (D.C. Cir. 1992). In determining whether a business transaction was an economic sham, two factors can be considered; "(1) did the transaction have a reasonable prospect, ex ante, for economic gain (profit), and (2) was the transaction undertaken for a business purpose other than the tax benefits?" *Id.* at 1237. The question of whether or not a transaction is a sham, for purposes of the doctrine, is primarily a factual one. *Lee v. Comm'r*, 155 F.3d 584, 586 (2nd Cir. 1998).

In this case, the facts are that the officially stated purpose of the LLC's formation was to conduct business, but that the Montana LLC had no business functions and never attempted to conduct any business of any kind. The titling of the RV in Montana, a state without a sales tax, was merely an attempt to reduce or eliminate Taxpayer's sales and use tax liabilities. The formation of the LLC and the titling of the RV in the name of the LLC was therefore a "sham transaction."

Since Taxpayer is an Indiana resident and he purchased the RVs, Taxpayer should have paid sales tax or use tax.

In conclusion, the formation of the LLC and the titling of the RVs by the LLC was a sham transaction. Taxpayer acquired tangible personal property in a retail transaction, used and stored it in Indiana, but did not pay sales tax at the point of purchase or anywhere else. In such circumstances, Indiana use tax is due, as explained by [45 IAC 2.2-3-4](#).

FINDING

Taxpayer's protest is respectfully denied.

II. Tax Administration – Negligence Penalty.

DISCUSSION

Taxpayer also protested the imposition of the ten percent negligence penalty pursuant to IC § 6-8.1-10-2.1. Indiana Regulation [45 IAC 15-11-2](#)(b) clarifies the standard for the imposition of the negligence penalty as follows:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The standard for waiving the negligence penalty is given at [45 IAC 15-11-2](#)(c) as follows:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc;

(5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Taxpayer has not affirmatively established, as required by [45 IAC 15-11-2\(c\)](#), that its failure to pay sales tax on its purchases was due to reasonable cause and not due to negligence.

FINDING

Taxpayer's protest is respectfully denied.

CONCLUSION

Taxpayer's protest of the use tax assessment is denied, as is Taxpayer's protest of the negligence penalty.

Posted: 09/29/2010 by Legislative Services Agency

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